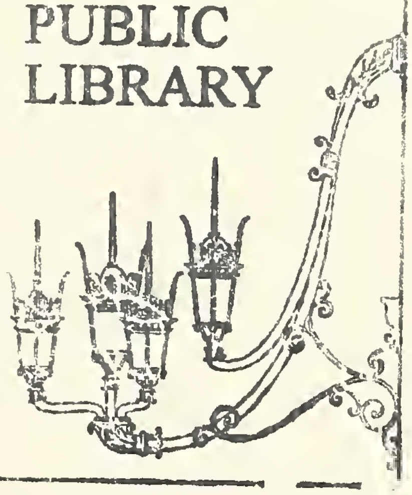

The Impact of Tax Reform on Community-Based Development

A One Day Conference

MASSACHUSETTS ASSOCIATION OF COMMUNITY DEVELOPMENT CORPORATIONS

MACDC

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BOSTON, MA 02111

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MASSACHUSETTS ASSOCIATION OF COMMUNITY DEVELOPMENT CORPORATIONS

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AGENDA

THE IMPACT OF TAX REFORM ON COMMUNITY-BASED DEVELOPMENT

	MODERATOR
	Mat Thall, Chairman, Tax Conference Committee, Massachusetts Association of Community Development Corporations
9:00 - 9:30	WELCOME AND OVERVIEW
	Walter R. Jennings, Manager, Corporate Contributions, John Hancock Mutual Life Insurance Company Kevin McQueen, Program Director, National Congress for Community Economic Development John Taylor, Chairman, Massachusetts Association of Community Development Corporations
9:30 -10:45	CHANGES IN MAJOR PROVISIONS
	Benson F. Roberts, Consultant, James Pickman and Associates James Millea, Esq., Hale and Dorr
10:45 -11:00	Break
11:00 -12:30	CHANGES AND IMPACT OF TAX PROVISIONS
	Benson F. Roberts, Consultant, James Pickman and Associates Linda Conroy, Director of Research and Program Development, Massachusetts Housing Finance Agency
12:30 - 1:30	Lunch
1:30 - 3:00	RESTRUCTURING INVESTMENT PARTNERS AND STRATEGIES
	Patrick Clancy, Executive Director, Greater Boston Community Development Barbara Cleary, President, Affirmative Investments
3:00 - 3:15	Break

(continued)

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3:15 - 4:15 SMALL DISCUSSION GROUPS/QUESTIONS AND ANSWERS, CASE STUDIES

1) Case Study: Low-income credit and future housing development

   Andrew Prague, Greater Boston Community Development

2) Case Study: Low-income credit and the acquisition of existing subsidized housing

   Lynn Wehrli, Greater Boston Community Development

3) Discussion: Opportunities for co-ops

   Jonathan Klein, Esq., Brown, Rudnick, Fried and Gesmer

4) Discussion: Historic Preservation

   Stanley Smith, Executive Director, Historic Boston

5) Discussion: Existing syndications - how to keep them viable

   Larry Einzig, Greater Boston Community Development

4:15 - 5:15 SMALL DISCUSSION GROUPS/QUESTIONS AND ANSWERS, CASE STUDIES

Repeat of sessions 1 - 5 above.

5:15 - 5:30 Wrap-up

5:30 - 7:00 Reception

TAX REFORM ACT OF 1986:
Provisions Affecting Cooperative Housing

Prepared by
Jonathan Klein, Esquire
Brown, Rudnick, Freed & Gesmer

For Presentation to
Cooperative Housing Task Force
Boston, Massachusetts
October 23, 1986

I. Introduction

The Tax Reform Act of 1986 (the "1986 Act") which was signed by President Reagan on October 22 significantly changes Federal income tax law. These changes lower tax rates, reduce deductions, eliminate many "tax shelters," and shift a major portion of the tax burden from individuals to corporations.

Several provisions have been made which will affect cooperative housing corporations and their tenant-stockholders. On a much larger scale, the 1986 Act will have a dramatic impact on real estate ownership and development generally.

Provisions directly affecting cooperative housing are outlined below in some detail in Section II. Several open issues for cooperative housing which were not addressed in the 1986 Act are summarized in Section III. Finally, provisions of the 1986 Act which affect real estate generally are listed, but with much less explanatory detail, in Section IV.

II. Provisions Affecting Cooperative Housing

A. Tax Exempt Bond Financing for Limited Equity Cooperative Housing

The 1986 Act rewrites the law on tax exempt bond financing for multi-family rental housing as well as many other activities. Previously, bonds for rental housing were issued primarily as "industrial development bonds" under Section 103(b)(4)(A) of the Internal Revenue Code. Industrial development bonds could be used, among other things, for "residential rental property," which did not include cooperative housing. Cooperative share loans could qualify for tax exempt bond financing under the mortgage subsidy bond provision, which is Section 103A of the Code, and which is generally applicable to single family homes. However, it was difficult to fit share loans within the 103A requirements, and, although the Massachusetts Housing Finance Agency has been very helpful in

trying to get a share loan financing program off the ground, no share loans have yet been financed under Section 103A in the Commonwealth of Massachusetts.

The 1986 Act in effect deletes the previous rules in Sections 103 and 103A, and sets up a new scheme of "private activity bonds" in new Sections 141 through 150 of the Code. Private activity bonds may be used to finance a variety of items, including low and moderate income rental housing and mortgages on 1-4 family owner-occupied residences. All private activity bonds are subject to a single state volume cap of $75.00 per resident of the state in 1987 and $50.00 per resident thereafter.

Limited equity housing cooperatives are specifically made eligible for private activity bond financing, and are to be treated as residential rental projects. To qualify, a housing cooperative must meet the definition of a cooperative housing corporation in Section 216(b)(1) and, in addition, must have limited equity provisions such that (to paraphrase the statute):

(1) the consideration paid for the stock by any stockholder entitled to occupy a house or apartment may not exceed the sum of --

(a) the consideration paid for the stock by the first stockholder, as adjusted by a cost of living adjustment determined by the Secretary of the Treasury,

(b) any payments made by the stockholder for improvements to the house or apartment, and

(c) payments attributable to the stockholder to amortize principal of the corporation's indebtedness arising from the acquisition or development of the corporation's real property or improvements thereto, and

(2) the value of the corporation's assets (reduced by any corporate liabilities), to the extent such value exceeds the combined transfer values of the outstanding corporate stock, may only be used for public benefit or charitable purposes, or directly to benefit the corporation itself, and may not be used directly to benefit any stockholder.

In addition, the cooperative must make an irrevocable election at the time of the issuance of the bonds. Any cooperative making such an election will <u>not</u> be eligible for the benefits of Section 216; that is, stockholders of any such cooperative will not be able to deduct their proportionate share of interest and taxes paid by the cooperative housing corporation. The cooperative housing corporation must meet the above requirements at all times during the qualified project period, which, in general, will be 15 years from the date the project is 50% occupied, or until the bonds are repaid, whichever is longer.

Any limited equity housing cooperative must meet all of the other targeting requirements for residential rental property. There are two alternative tests, the "20-50" test, in which 20% of the units are occupied by individuals whose income is 50% or less of the area median, or the "40-60" test, in which 40% of the units are occupied by individuals whose income is 60% or less of area median. Incomes are determined based on family size, and determinations must be made annually. If any tenant family which qualifies as low income when it moves into the housing has its income increased to an amount greater than 140% of the then-qualifying income, it would no longer qualify to meet the low income requirements, and the next available unit in the property would have to be rented to a qualified low income family. There is a special rule for a "deep rent skewed" project, in which 15% or more of the low income units must be rented to residents with incomes less than 40% of the area's median gross income, gross rents on all "low income units" must be less than 30% of income (after taking subsidies into account), and gross rents on the "low income units" must not exceed 1/3 of the average rent on non-low income units of comparable size. In the case of a deep rent skewed project, a family will only be deemed to not qualify when its income is 170% of the applicable income limitation, and in such a case, the next available unit must be occupied by a family whose income does not exceed 140% of the applicable limitation.

As stated above, the project must comply with these requirements throughout the qualified project period, which will generally be approximately 15 years, and the operator of the project must so certify each year. If the project does not comply at any time during the period, all interest on the bonds from the date of issuance will be deemed not tax exempt.

Many other technical restrictions will be applicable to these private activity bonds. Although the cooperative housing community considered it a long sought victory to allow the inclusion of limited equity cooperatives within the bond financing program, the tight targeting requirements and the limited available volume may make the victory of less consequence than originally thought.

The 1986 Act will continue to allow bond financing for share loans to stockholders in a qualified cooperative housing corporation; for this purpose, a qualified cooperative housing corporation is defined as one which meets the requirements in Section 216(b)(1).

Effective Date. With certain exceptions, the 1986 Act is effective for bonds issued after August 15, 1986.

B. Deductibility of Interest on Cooperative Share Loans

Under current law, all interest is deductible by individual taxpayers who itemize their deductions. The 1986 Act makes radical changes in this rule, and generally restricts interest deductions to qualified residence interest incurred with respect to the taxpayer's principal residence and one other residence, to the extent such interest does not exceed the cost of the home plus improvements. Interest on additional mortgage indebtedness (up to fair market value of the home incurred for qualified educational or medical expenses may also be deducted.

Interest on cooperative share loans was not initially included as qualified residence interest; after a lobbying effort, however, a special rule was included for cooperative housing corporations (as defined in Section 216), which provides that interest secured by the stock held by the taxpayer in a cooperative housing corporation is be treated as secured by the house or apartment which the taxpayer is entitled to occupy. In addition, if such stock may not be pledged to secure indebtedness (by virtue of the cooperative's articles or bylaws), the interest may nevertheless be deductible if the taxpayer can establish that the indebtedness was in fact incurred to acquire the stock.

The effect of this provision is to ensure that cooperatives receive the same treatment as other forms of home ownership.

Effective Date. These provisions are effective for taxable years beginning after December 31, 1986.

C. Amendments to Section 216

1. Proportionate Share Rule. Section 216 of the Internal Revenue Code is the basic provision which defines cooperative housing corporations and allows tenant-stockholders of a qualified cooperative housing corporation to deduct the amount of their rent or carrying charge payment which is equal to their pro-rata share of the interest on the cooperative's blanket mortgage and real estate taxes incurred by the corporation. Section 216 currently provides that these deductions are to be allocated to the individual stockholders in proportion to their stock ownership in the corporation, and further requires that stock in the corporation initially be allocated in accordance

with the initial value of the units which the stock applies. (The regulations actually limit the amount which is deductible to the greater of the amount allocated in accordance with the foregoing formula or the amount which can actually be attributed to payments made by the stockholder; hence, if a stockholder does not pay his or her carrying charges for an entire year, that stockholder would not be entitled to any Section 216 deductions, since the stockholder would not have paid any amounts which actually went to pay interest or real estate taxes.)

This inflexible requirement for the allocation of interest and real estate taxes has led to some minor problems and inequities in the application of Section 216. The most notable example is in California, where, under state law, upon the sale of the stock and transfer of an occupancy agreement for a unit in a housing cooperative, that "unit" is reassessed for real estate tax purposes. Most cooperatives pass this increased assessment applicable solely to the unit on to the stockholder who resides in that unit; however, under Section 216, the stockholder could not take the deductions attributable to the increased assessment. A similar problem is encountered with so-called "deep equity" cooperatives, which are becoming popular among the elderly. In these cooperatives, some members prepay their share of the blanket mortgage, and hence have little of no interest expense attributable to their payments. Nevertheless, because of the mechanics of Section 216, other tenant stockholders would get smaller interest deductions than they should be entitled to.

The 1986 Act includes a section allowing a cooperative housing corporation to make a special election with respect to how interest and tax deductions are allocated to stockholders, so long as the election reasonably reflects the amounts actually paid by the stockholders with respect to interest and taxes paid by the corporation. Elections may be made separately for interest and taxes. Once made, an election may be revoked only with consent of the Secretary of the Treasury.

<u>Effective Date</u>. In general, the amendments to Section 216 apply to taxable years beginning after December 31, 1986.

2. <u>"Individual" to "Person"</u>. Section 216 currently requires that, with certain limited exceptions, a tenant stockholder in a cooperative housing corporation be an "individual." In tax lingo, this means that the stockholder must be a living, breathing person, and not a corporation, partnership, trust, or other legal entity. This has caused minor inconveniences for some cooperatives, especially in New York City, since it restricts corporate ownership of cooperative apartments for employees, prevents acquisition of cooperative apartments by partnerships or other investment vehicles, and creates the risk of a cooperative violating the "80/20 test" if an individual stockholder dies. In the last case, since the stockholder's estate is not deemed to be an "individual," the

income from the unit will be counted as non-member income under the 80/20 test; if together with other non-member income, this puts the total of such income over the 20% limitation, all stockholders would be denied their Section 216 deductions.

Segments of the New York co-op community have been lobbying for a change to this rule for some time to allow a "person" (which despite the apparent meaning actually means any legal entity for purposes of the Internal Revenue Code) to be eligible tenant-stockholders. This change was opposed by the National Association of Housing Cooperative, on the theory that cooperatives were for people, not persons, and that encouraging investor or corporate ownership would undermine basic cooperative principals. At the last minute, however, Senator Moynihan proposed an amendment making the change, which was eventually adopted.

In addition to changing individual to person for purposes of Section 216, the amendment also liberalizes the rule which requires that the stockholder be "entitled...to occupy for dwelling purposes a house, or an apartment" in a building owned by the cooperative. The new law provides that the cooperative housing corporation may actually prohibit the stockholder from occupying the unit in several cases, including those where a person acquires stock by operation of law, where any person other than an individual acquires the stock, and in any case where the original seller of the building to the cooperative acquires the stock within one year of the date of the sale.

The effect of these provisions will be to liberalizes the requirements regarding ownership of stock, and to make cooperatives more flexible tools for development. It will also relieve existing problems for some existing cooperatives, largely in New York City. The liberalized rules will not affect any existing cooperative which currently limits membership to individuals in its articles of organization or bylaws, or a future cooperative which wishes to so limit its membership. Accordingly, this change will probably have a limited impact on many of the cooperatives in the Boston area.

3. <u>Technical Changes to Depreciation Rules</u>. In the case of a tenant-stockholder which owns a cooperative apartment for use in a trade or business, there is a special rule in Section 216(c) allowing the tenant-stockholder to take depreciation deductions with respect to his stock in the cooperative. This rule is necessary since stock is not normally depreciable. The 1986 Act makes what appears to be a technical correction in limiting the amount of depreciation deduction of such stock to the adjusted basis of the stock as of the close of the taxable year in which the deduction was incurred. Any deductions disallowed under this rule may be carried forward, apparently indefinitely.

4. Disallowance of Deductions for Payments Attributable to Capital. The 1986 Act includes a further technical adjustment by creating what will be Section 216(d), and which appears to be a result of the "individual to person" change. In general, someone using a cooperative apartment for a trade or business would be entitled to deduction for rent paid to the cooperative, since rent is normally a deductible expense. However, in the case of a cooperative, a portion of the rent may go to pay for capital items (such as capital improvements, or amortization of principal on the corporation's mortgage), which if paid directly by the business tenant-stockholder, would not be deductible. Accordingly, the new Section 216(d) will disallow deductions for any such items, and will provide that they should be added to the stockholder's adjusted basis in its stock in the cooperative housing corporation. This change will not have any impact on any person who does not use a cooperative apartment for business purposes.

5. Changes for Mitchell-Lama Cooperatives. The 1986 Act also includes further technical changes to provide relief for certain limited equity cooperatives in New York built under the Mitchell-Lama program in the early 1960's. Many of these cooperatives were recently refinanced, and, absent this change, would have faced the possibility of paying substantial taxes on refinancing proceeds which went to create necessary replacement reserves.

III. Cooperative Housing Tax Issues Not Addressed.

There are still a number of problems with Section 216 and the taxation of housing cooperatives and their members which were not addressed as part of the 1986 Act. These will remain part of the legislative agenda for both the National Cooperative Business Association and the National Association of Housing Cooperatives. Briefly, these open issues include the following:

A. "80/20" Test. As mentioned above, Section 216 requires that 80% of the cooperative's income be "derived" from tenant-stockholders. In cooperatives with significant amounts of commercial space, this limitation has proved troublesome. It is especially problematic since it is a "bright line" test; that is, if a cooperative crosses the line in any year, all members in the cooperative would lose their Section 216 deductions in that year. Several alternatives have been proposed, including a "principal purpose" test to replace the 80/20 test, but these changes are not supported by the administrative staff at either the Treasury Department or the Joint Tax Committee, and still remain open.

B. Section 277 Income. Section 277 appears to require that cooperatives pay taxes on any "non-member" income, to the extent it exceeds deductions directly attributable to that income. The two biggest areas of concern here are income from commercial rentals and interest income on reserves. Income on commercial

rentals is usually not a significant problem, since the cooperative may allocate a portion of its depreciation deductions and other expenses applicable to that space to offset the income. However, a cooperative seldom has offsetting deductions to its interest income, and the Internal Revenue Service has taken the position that this income is not "derived" from members; accordingly, it is not allowed to be offset by the corporation's other deductions. This problem is a serious one for many older cooperatives with large reserves, and a test case may be litigated in the near future. In the meantime, the cooperative housing community has been unable to reach agreement with the administrative staff at the Treasury Department and the Joint Tax Committee on a proposed solution. There are a number of issues involved which are beyond the scope of this summary.

C. Mobile Home Park Cooperatives. Section 216 defines a cooperative housing corporation as one in which the tenant-stockholders are entitled to occupy for dwelling purposes a house or apartment in the cooperative. Mobile home parks, which only own land and not houses or apartments, are thus ineligible for Section 216 deductions. An amendment to Section 216 was proposed, but was controversial and was dropped. Further legislative work is needed in this area.

IV. Changes Affecting Real Estate Generally.

Below is merely a listing of provisions which generally affect real estate ownership and development, and which may affect the ability to develop future cooperative housing. These are described in much less detail than those provisions set forth above.

A. Changes in Tax Rates. As is now well known, the highest marginal tax rates for 1988 have been reduced to 28% for individuals and 34% for corporations (actually slightly higher on certain income as a result of the phasing out of lower rates). The highest marginal rates for 1987 will be 37.5% for individuals and 40% for corporations. These lower rates will have the effect of making all deductions and "tax shelters" less valuable.

B. Passive Activity Rules. In a broad attack on the real estate tax shelter industry, a new set of rules has been adopted which prevents individuals from using losses and credits from so-called "passive activities" to reduce either "active income" (salaries and earned income) or "portfolio income" (interest and stock dividends, etc.). Passive losses may only be used to offset passive income. There is a limited exception for up to $25,000 of losses on rental property owned and actively managed by individuals, but this exemption is phased out for individuals with incomes between $100,000 and $125,000. Virtually all losses from real estate are defined as "passive losses." These rules eliminate the usefulness of real estate limited partnerships as a tax sheltering device. There is a special transition rule for

low income housing which preserves passive losses for up to seven years in limited cases and a special exception for the low income housing tax credits.

C. Depreciation and Cost Recovery. The current Accelerated Cost Recovery System (ACRS) allows for the depreciation of real property other than low-income housing over 19 years (based on a 175% declining balance method switching to straight line method) and the depreciation of low-income housing over a 15 year recovery period (based on a 200% declining balance method switching to straight line). The 1986 Act effectively eliminates ACRS, although current depreciation schedules will remain in effect for all property placed in service prior to the effective date of this section, which is December 31, 1986, with certain transition rules. In the future, all real estate is to be depreciated on a straight line basis, with residential property depreciated over 27.5 years and all other real estate depreciated over 31.5 years.

D. Capital Gains. Although the concept of capital gains remains important for some purposes, the 60% deduction for long term capital gains which allows them to be taxed at a lower rate (currently a maximum of 20%) has been eliminated; accordingly, all capital gains will be subject to the same rates as ordinary income effective for taxable years beginning after December 31, 1986. For 1987 only, there is a special maximum capital gains rate of 28%. One side effect of this change, together with the reduction in marginal rates, is to eliminate the importance of "depreciation recapture" on existing tax shelters, since all gain on sale of a project will be treated as ordinary income, but will be taxed at somewhat lower rates than at present.

E. Amortization of Rehabilitation Costs for Low Income Housing. Current Section 167(k), which allows five year amortization of expenditures to rehabilitate low-income housing, will be permitted to expire on December 31, 1986 except in cases where the rehabilitation began or a binding contract was in place prior to January 1, 1987.

F. Construction Period Interest and Taxes. Currently, construction period interest and taxes are amortized over 10 years, except in the case of low income housing, with respect to which they may be deducted currently. Under the 1986 Act, these rules are repealed, and replaced with a new set of rules that in effect requires capitalization (and depreciation over 27.5 years or 31.5 years) of all such costs.

G. Rehabilitation Tax Credits. The current tax credit of 25% on historic structures, 20% for 40+ year old buildings, and 15% for 30-40 year old buildings is deleted. The new rules under the 1986 Act provide for a 20% tax credit for historic structures, and a 10% credit for rehabilitation expenditures on any other structure placed in service before 1936. Unlike

current law, the 20% credit will reduce the basis of the building by 100% of the amount of the credit. As before, residential buildings are eligible only for the 20% credit for historic structures, and not for the 10% credit. The credit, however, is subject to the passive activity rules, which will drastically reduce its utility.

H. Extension of "At Risk" Rules. The current law generally provides that taxpayers may deduct losses in connection with an investment only to the extent they are "at-risk" with respect to their investment. Accordingly, deductions are limited to the amount of their investment and any loans on which they are personally liable. In the past, most real estate activities have been exempt from this rule. Under the 1986 Act, at-risk rules are extended to all real estate, with the sole exception that certain institutional nonrecourse debt will continue to be exempt from the at-risk limitations.

I. Alternative Minimum Tax. The alternative minimum tax for both individuals and corporations is modified and strengthened, further lessening the value of certain tax sheltering arrangements.

J. Limitations on Deductions for Interest. The general rules, and their effect on cooperative share financing, are described in Section II.B above. In addition, for noncorporate taxpayers, the 1986 Act provides further limitations on "investment interest," the effect of which will be to even further limit the utility of certain tax sheltering arrangements.

K. Installment Sales Rules. Under current law, gain attributable to a sale where payment is made in installments over time must only be recognized as installments are received, with the exception of depreciation recapture. In the past, sellers have taken advantage of this rule to delay recognition of income, but have then pledged the installment notes they have received in order to obtain immediate cash. The 1986 Act places limitations on this practice which will reduce the utility of the installment sale provisions.

L. Low-Income Housing Tax Credits. The effect of many of the above provisions is to severely curtail the ability to use investment in real estate, either directly or through a syndicated offering, to shelter other income. Although it can be expected that the tax shelter industry will find creative ways to work with the new rules, it is likely that availablity of real estate tax shelters will be drastically reduced. This will have a profound affect on the development of housing, and especially low and moderate income housing, which has been heavily subsidized in recent years through tax sheltering arrangements. All these prior incentives which are now unavailable have been replaced by a new scheme of low income housing tax credits. The credits are also granted an exemption from the passive activity

rules. The exemption is fully available for taxpayers with income up to $200,000, and is phased out for taxpayers with income between $200,000 and $250,000. In addition, corporations are not subject to the passive activity rules. Although corporations have typically not been significant purchasers of limited partnership tax shelters, they may increasingly become a focus of an effort to market such interests.

The credit, which is granted each year for 10 years, is initially 9% per year of qualified basis for new construction and rehabilitation of projects which are not federally subsidized, 4% per year for projects which are federally subsidized, and 4% per year for the acquisition of existing low income housing. The credit applies only to basis attributable to eligible low income units, and may only be used in a project which has a minimum of either 20% of the units with rent restrictions and occupied by households with incomes of 50% or less of area median, or 40% of the units with rent restrictions and occupied by households with incomes of 60% or less of the median. The income test is adjusted for family size, and rent must be restricted so that it does not exceed 30% of the applicable income limit. The rent restriction and income test must be met for 15 years.

The credit is claimed annually for a period of 10 years. It is intended that the 9% credit have a present value of 70%, and the 4% credit have a present value of 30%; the Secretary of the Treasury is instructed to adjust the rates of credit for buildings placed in service after 1987 in order to maintain those present values. Once a project is placed in service, however, the rate of credit does not change.

The basis of the portion of a building eligible for the credit is computed using the smaller of the ratio of the number of low income units to all units, or the ratio of the square footage attributable to low income units to the total square footage of all residential units. Any grants with respect to the building from federal funds (CBDG or UDAG grants) are subtracted from the qualified basis. The credit will be in place for only three years, beginning in 1987 and ending in 1989, except that, in certain cases, the credit may remain available for projects placed in service before January 1, 1991.

The credit is subject to a state allocation system and cap. The cap is $1.25 per resident of the state, and includes only the first year credits (not all 10 years) taken in the applicable year. 10% of the credit authority must be allocated to qualified nonprofit organizations. If 70% of the project is financed by tax exempt bonds, then the credits for that project are not subject to the state cap, since the bonds will be subject to separate cap limitations.

The maintenance rules for the project are similar to those described above for tax exempt bonds; that is, if the income of a tenant in a qualifying unit increases to 140% of the then qualifying maximum, the next available qualifying unit must be rented to a qualifying tenant. The operator of the housing must certify compliance annually.

THIS IS AN EXTREMELY ABBREVIATED SUMMARY; THERE ARE NUMEROUS ADDITIONAL DETAILS WHICH WILL GOVERN THE APPLICATION AND UTILITY OF THE LOW INCOME HOUSING CREDIT AS WELL AS THE MANY OTHER PROVISIONS LISTED ABOVE.

CASE STUDIES
AND
RELATED MATERIALS
FOR

MASSACHUSETTS ASSOCIATION OF COMMUNITY DEVELOPMENT CORPORATIONS

Conference on

THE IMPACT OF TAX REFORM ON COMMUNITY-BASED DEVELOPMENT

January 26, 1987

GREATER BOSTON COMMUNITY DEVELOPMENT, INC.

CONTENTS

ATTACHMENT #1

LOW INCOME HOUSING TAX CREDIT

Fact Sheet

General

The Low Income Housing Tax Credit, created in the Tax Reform Act of 1986, is the key tax benefit available for use in low income housing investments, and replaces virtually all previously available benefits to low income housing, including accelerated depreciation, 167(k), etc.

Eligibility

A qualified low income housing project is one in which:

1. 20% or more of the units are rent restricted and occupied by tenants whose income is 50% or less of median income, or

2. 40% or more of the units are rent restricted and occupied by tenants whose income is 60% or less of median income.

A rent restricted unit is one in which the gross rent does not exceed 30% of the relevant income limitation cited above. (Gross rent does not include federal Section 8 or other state and local rent subsidy payments.)

A qualified low income building is one which:

1. is part of a qualified low income housing project throughout the 15-year compliance period of the credit, and

2. is subject to new depreciation rules in the Tax Reform Act of 1986, and

3. is placed in service between 1/1/87 and 12/31/90.

Credit Amount Calculations

The amount of the annual credit, available for a ten-year period, is calculated according to the following formula:

Qualified Basis x Applicable Fraction = Eligible Basis

Eligible Basis x Applicable Percentage = Annual Credit Amount

Qualified Basis is the development cost of a new construction project, less land costs and in some cases, federal subsidies.

Qualified Basis in an existing project would include acquisition costs (excluding land) plus rehabilitation costs, less federal subsidies in some cases.

Credit Amount Calculation, continued

The Applicable Fraction is the lesser of low income units to total units, and low income floor space to total floor space.

The Applicable Percentage is determined on the basis of project type (i.e., new construction vs. rehabilitation) and by the use of federal subsidies, as shown below:

	Rehabilitation or Resyndication					New Const.
	Rehab = More Than $2,000/Un.		Rehab = Less Than $2,000/Un.		Acquis. Cost	Con-struc-tion Cost
Federally Subsidized Projects*	4%	or	4%	plus	4%	4%
Unsubsidized Projects	9%	or	4%	plus	4%	9%

* Includes mortgage financing with federally subsidized tax exempt bonds and/or below market rate federal loans or grants for which Qualified Basis is not reduced.

State Credit Limitations

State agencies will allocate credits to projects and allocations are completed during the year in which the project is placed in service. Each state is limited to a total credit cap of $1.25 per capita for the years 1987 through 1989. However, only the first year of a project's credit is counted against the cap. The 4% credits used in tax-exempt bond-financed projects are not subject to the credit cap either, since they are controlled instead by bond caps.

Individual Investment Benefit Limitations

No individual investor may claim more than $7,000 per year in the low income housing credit against salary- or portfolio-generated tax liability, because of limits related to other passive loss restrictions. Additionally, the amount of credit available to individual investors is decreased ratably to 0 as individual income increases from $200,000 to $250,000. Therefore, credit transactions must be oriented to corporations not affected by passive loss restrictions, or to larger numbers of individual investors, requiring public offerings for all but relatively small projects.

Prepared by Greater Boston Community Development, Inc., January 1987

ATTACHMENT #2

NEW BUILDING BLOCKS OF EQUITY FINANCING

The attached analyses are designed to indentify the various components and the possible combinations of tax benefits available to projects syndicated with the low income housing tax credit. Separate analyses are provided for new construction and rehabilitation projects. The calculations are oriented toward Massachusetts development efforts, in that they incorporate the value of losses derived from the State Housing Assistance for Rental Production (SHARP) program. However, estimates of syndication results are also provided for non-SHARP projects.

Each analysis provides information on assumptions concerning development costs and syndication pricing. For both analyses, it is further assumed that corporate investors would be sought, as corporations would benefit from all of the tax benefits (i.e., including losses) which could be generated. Consequently, losses are valued with the use of the maximum corporate tax rate. The schedules also provide a listing of the various potential component parts of tax benefits available, in the upper right hand section of each schedule. Two values are provided for the 9% low income housing credit: the first for projects which are not federally subsidized (1.), and the second for projects which are federally subsidized (1(S).). The latter reflects the reduction in qualified credit basis required when capital subsidies are used with the 9% credit.

Although the analyses offer only rough estimates of syndication values applicable under the particular assumptions made, the "Alternative Combinations" of benefits on each schedule should be of use in understanding the nature of certain tradeoffs to be made in structuring a development project which is to be syndicated, and in obtaining "ballpark" estimates of the amount of equity which could be raised for a particular kind of project.

Prepared by Greater Boston Community Development, Inc., January 1987

BUILDING BLOCKS OF EQUITY FINANCING

NEW CONSTRUCTION MODEL

Development Cost Summary

Construction/Development Cost	80,000
Acquisition Cost	5,000
Reserves	8,500
Total Development Cost	93,500
Credit Basis (Unsubsidized)	88,500
Credit Basis (Subsidized)	83,500
Depreciable Base	88,500

Syndication Assumptions

Limited Partner Interest	99%
Syndication Pay in Years	7
Net Benefit Ratio	1.15
Maximum Tax Bracket Corp	34%
Syndication/Bridge Loan Costs	35%
SHARP Annual Loan	3,240
Capital Subsidy – grant	5,000

over

Equity Components

		Gross Value	Net Value	Net as Percent of TDC
1. Low Income Housing Credit	9%	47,998	31,199	33%
1(S). Low Income Housing Credit	9%	45,286	29,436	31%
2. Low Income Housing Credit	4%	21,332	13,866	15%
3. Losses without SHARP		6,594	4,286	5%
4. Losses with SHARP		14,315	9,305	10%
5. Losses With SHARP and Capital Subsidy		15,048	9,781	10%

Alternative Combinations

TYPE A		Gross Value	Net Value	Net as Percent of TDC
1. Low Income Housing Credit	9%	47,998	31,199	33%
3. Losses without SHARP		6,594	4,286	5%
Total		54,591	35,484	38%

TYPE B		Gross Value	Net Value	Net as Percent of TDC
1. Low Income Housing Credit	9%	47,998	31,199	33%
4. Losses with SHARP		14,315	9,305	10%
Total		62,313	40,503	43%

TYPE C		Gross Value	Net Value	Net as Percent of TDC
1(S). Low Income Housing Credit	9%	45,286	29,436	31%
5. Losses With SHARP and Capital Subsidy		15,048	9,781	10%
Total		60,334	39,217	42%

TYPE D		Gross Value	Net Value	Net as Percent of TDC
2. Low Income Housing Credit	4%	21,332	13,866	15%
3. Losses without SHARP		6,594	4,286	5%
Total		27,926	18,152	19%

TYPE E		Gross Value	Net Value	Net as Percent of TDC
2. Low Income Housing Credit	4%	21,332	13,866	15%
4. Losses with SHARP		14,315	9,305	10%
Total		35,647	23,171	25%

TYPE F		Gross Value	Net Value	Net as Percent of TDC
2. Low Income Housing Credit	4%	21,332	13,866	15%
5. Losses With SHARP and Capital Subsidy		15,048	9,781	10%
Total		36,380	23,647	25%

Prepared by Greater Boston Community Development, Inc., January 1987

BUILDING BLOCKS OF EQUITY FINANCING

REHABILITATION MODEL

Development Cost Summary

Construction/Development Cost	50,000
Acquisition Cost	15,000
Reserves	6,500
Total Development Cost	71,500
Credit Basis (Unsubsidized)	56,500
Credit Basis (Subsidized)	51,500
Land @ 20% of Acquisition	3,000
Depreciable Base	68,500

Syndication Assumptions

Limited Partner Interest	99%
Syndication Pay in Years	7
Net Benefit Ratio	1.15
Maximum Tax Bracket	34%
Syndication/Bridge Loan Costs	35%
SHARP Annual Loan	3,240
Capital Subsidy	5,000
ITC @ 20%	11,300

Equity Components

	(Rehab.	Acq.)	Gross Value	Net Value	Net as Percent of TDC
1. Low Income Housing Credit	9%	+ 4%	33,535	21,798	30%
1(5). Low Income Housing Credit	9%	+ 4%	30,823	20,035	28%
2. Low Income Housing Credit	4%	+ 4%	16,511	10,732	15%
3. Losses without SHARP			4,262	2,770	4%
4. Losses with SHARP			11,983	7,789	11%
5. Losses With SHARP and Capital Subsidy			12,716	8,265	12%
6. Historic Rehab Credit			9,728	7,782	11%

Alternative Combinations

TYPE A		Gross Value	Net Value	Net as Percent of TDC
1. Low Income Housing Credit	9% + 4%	33,535	21,798	30%
3. Losses without SHARP		4,262	2,770	4%
Total		37,797	24,568	34%

TYPE B		Gross Value	Net Value	Net as Percent of TDC
1. Low Income Housing Credit	9% + 4%	33,535	21,798	30%
3. Losses without SHARP		4,262	2,770	4%
6. Historic Rehab Credit		9,728	7,782	11%
Total		47,525	32,350	45%

TYPE C		Gross Value	Net Value	Net as Percent of TDC
1. Low Income Housing Credit	9% + 4%	33,535	21,798	30%
4. Losses with SHARP		11,983	7,789	11%
Total		45,518	29,587	41%

TYPE D		Gross Value	Net Value	Net as Percent of TDC
1. Low Income Housing Credit	9% + 4%	33,535	21,798	30%
4. Losses with SHARP		11,983	7,789	11%
6. Historic Rehab Credit		9,728	7,782	11%
Total		55,246	37,369	52%

TYPE E		Gross Value	Net Value	Net as Percent of TDC
1(5). Low Income Housing Credit	9% + 4%	30,823	20,035	28%
5. Losses With SHARP and Capital Subsidy		12,716	8,265	12%
Total		43,539	28,301	40%

TYPE F		Gross Value	Net Value	Net as Percent of TDC
1(5). Low Income Housing Credit	9% + 4%	30,823	20,035	28%
5. Losses With SHARP and Capital Subsidy		12,716	8,265	12%
6. Historic Rehab Credit		9,728	7,782	11%
Total		53,267	36,083	50%

TYPE G		Gross Value	Net Value	Net as Percent of TDC
2. Low Income Housing Credit	4% + 4%	16,511	10,732	15%
3. Losses without SHARP		4,262	2,770	4%
Total		20,773	13,503	19%

TYPE H		Gross Value	Net Value	Net as Percent of TDC
2. Low Income Housing Credit	4% + 4%	16,511	10,732	15%
3. Losses without SHARP		4,262	2,770	4%
6. Historic Rehab Credit		9,728	7,782	11%
Total		30,501	21,285	30%

TYPE I		Gross Value	Net Value	Net as Percent of TDC
2. Low Income Housing Credit	4% + 4%	16,511	10,732	15%
4. Losses with SHARP		11,983	7,789	11%
Total		28,494	18,521	26%

TYPE J		Gross Value	Net Value	Net as Percent of TDC
2. Low Income Housing Credit	4% + 4%	16,511	10,732	15%
4. Losses with SHARP		11,983	7,789	11%
6. Historic Rehab Credit		9,728	7,782	11%
Total		38,222	26,304	37%

TYPE K		Gross Value	Net Value	Net as Percent of TDC
2. Low Income Housing Credit	4% + 4%	16,511	10,732	15%
5. Losses With SHARP and Capital Subsidy		12,716	8,265	12%
Total		29,227	18,998	27%

TYPE L		Gross Value	Net Value	Net as Percent of TDC
2. Low Income Housing Credit	4% + 4%	16,511	10,732	15%
5. Losses With SHARP and Capital Subsidy		12,716	8,265	12%
6. Historic Rehab Credit		9,728	7,782	11%
Total		38,955	26,780	37%

Prepared by Greater Boston Community Development, Inc., January 1987

ATTACHMENT #4

LOW INCOME HOUSING CREDITS FOR EXISTING PROPERTIES/RESYNDICATION

Fact Sheet

A. Low Income Housing Credits are available for acquisition and/or rehabilitation costs for eligible projects.

B. The "Applicable Percentage" is 4%, unless a rehabilitation, treated as a "new building" and costing at least $2,000 per unit, is undertaken. If rehab is completed, a 9% credit may be taken against rehabilitation expenditures. The 4% credit may then be taken as well against the remaining eligible basis (i.e., the eligible basis not attributable to rehab expenditures).

C. The "Eligible Basis" is:

   1. the portion of adjusted basis attributable to acquisition cost; plus

   2. capitalized amounts incurred by the taxpayer before the end of the first taxable year of the credit period.

D. The building must be acquired by "purchase" as defined in code Section 179(d)(2) (related party transfer rules).

E. There must be a period of at least 10 years between the acquisition date and the later of;

   1. the last date the property was placed in service; or

   2. the most recent "nonqualified substantial improvement". Nonqualified substantial improvement is one in which:

      a. 167(k) or 168 was elected; and

      b. the amounts added to the capital account during any 24 month period exceeded 25% of the adjusted basis of the building on the first day of the 24 month period.

      c. (the date at which the 10 year period starts is the last day of the 24 month period).

   3. The building must not have been placed in service by the taxpayer or any related person (to the taxpayer) when the building was previously placed in service.

   4. The building will not be considered to have been placed in service in a "nontaxable exchange" in which the basis of the property in the hands of the purchaser is determined in whole or in part by reference to the adjusted basis of the seller.

5. The Secretary of HUD may waive the 10 year period for certain distressed properties financed, assisted or operated under the Section 8, Section 221(d)(3), Section 236 or Section 515 (FHA) programs.

F. The eligible basis will be reduced by the amount of any federal grants received during the compliance period.

G. Financing from a qualified nonprofit organization may be problematic in resyndications because to meet the new at risk provisions, such financing must:

1. account for 60% or less of the eligible basis at the end of any taxable year of the compliance period; and

2. be fully repaid at the earliest of:

    a. the maturity date; or

    b. the 90th day after the close of the 15 year compliance period; or

    c. the date of sale or refinancing; and

3. the financing must be secured by the property; and

4. the interest rate must be no lower than 1% below the Applicable Federal Rate (AFR).

Secondary financing secured by the property is prohibited by the regulatory and mortgage documents of some federal programs (e.g., FNMA).

H. Other eligibility factors, restrictions, definitions, etc., including those listed below, are the same as for other applications of the Low Income Housing Credit:

1. dates for which credit is available;

2. applicable fraction;

3. credit period and compliance period;

4. "qualified low-income housing project", "qualified low-income building", and "low-income unit"; and

5. other "special rules".

I. Transfers of HUD-financed or HUD-insured projects require HUD Transfer of Physical Assets (TPA) processing, which can be extremely time consuming.

J. Transfers of MHFA financed projects also require agency processing.

Prepared by Greater Boston Community Development, Inc., December 1986

ATTACHMENT #5

CASE STUDY # 2

LOW INCOME HOUSING TAX CREDIT AND ACQUISITION/REHABILITATION OF EXISTING PROJECTS

Project Profile

Number of Units	145
Percent # =< 60% of Median	100%
Financing and Subsidies; HUD Section 236 Insurance; HUD Section 236 Interest Subsidy; Section 8 Contract (all units)	
Planned Rehabilitation (@ 15% of mortgage Balance, per HUD)	405,645

Valuation / Debt Summary Calculation

Appraised Value of Real Estate	4,830,000
95% of Appraised Value	4,588,500
(Less) First Mortgage	(2,704,298)
Plus Financial Assets	
Working Capital	40,689
Replacement Reserves	119,962
Total = Second Mortgage Principal	2,044,853

Syndication Structuring

Pay In Period (Years)	7
Net Benefit Ratio	1.15
Maximum Tax Bracket (Corporate)	34%
Allocation to Limited Partners	99%
Holding Period (Years)	15
Syndication / Bridge Financing Cost	35%

Syndication Summary

A. Low Income Housing Credit

Total Basis: Purchase Price	4,749,151
Less Land	(876,000)
Plus Rehabilitation	405,645
Qualified Basis	4,278,796
Acquisition Amount	3,873,151
Rehab Amount	405,645
Applicable Fraction (Low income units / Total units)	100%
Eligible Basis (Qualified Basis X Applicable Fraction)	
Acquisition Amount	3,873,151
Rehab Amount	405,645
Annual Credits	
Acquisition Amount X 4%	154,926
Rehab Amount X 9%	36,508
	191,434

B. Depreciation

Depreciable Base: Appraised Value	4,830,000
Less Land Cost	(876,000)
	3,954,000
Annual Depreciation (Straight Line, 27.5 Years)	143,782

C. Other Losses

These estimated losses are generated from interest accruals on secondary debt, fee deductions, etc.

Annual Estimated Losses	416,292

D. Amortization

Syndication benefits are reduced by mortgage amortization, which becomes significant in older housing projects.

Average Annual Amortization	45,745

Syndication Value

Components	Gross Value	Net Value
A. Credit	1,153,598	749,839
B. Depreciation	294,590	191,484
C. Other Losses	852,927	554,403
D. Amortization	(320,215)	(208,140)
Total	1,980,901	1,287,585

Uses of Proceeds

Syndication\Bridge Loan Costs	693,315
Rehabilitation	405,645
Payment to Original Limited Partners	350,000
Balance/Interest Payments to Sponsor	531,941
	1,980,901

Case Study prepared by Greater Boston Community Development, for "The Impact of Tax Reform on Community-Based Development" Conference, January 26, 1987

ATTACHMENT #6

Low-Income Housing Transition Rule

Fact Sheet

Because low-income housing relies heavily on tax benefits accruing to limited partners, Congress was concerned that if no provisions were made in the Tax Reform Bill, current investors would decide to default on their obligations to make future installment payments. To avoid the potentially harmful effects on these projects, a special transition rule for low-income housing was contained in the Bill.

Section 5.02 of the Tax Reform Bill of 1986 allows for full deductibility of all losses allocated to a "qualified investor" in a "qualified low-income housing project" through the "relief period". These terms are defined below. In addition, the Bill stipulates that these losses can be used to reduce income used in determining the Alternative Tax liability.

Qualified Investor: A "qualified investor" is an investor who holds an interest in a "qualified low-income project" and

A)
  i) the interest was held by August 16, 1986 if the project was placed in service by that date and the investor made his initial investment after December 31, 1983 or

  ii) the interest was held by December 31, 1986 for projects placed in service after August 16, 1986 and

B) the investor is required to make 50% or more of his/her total original obligated investment after December 31, 1986.

Qualified Low-Income Project: A "qualified low-income project" is one that

A) meets the requirements of Section 1250(a)(1)(b) of the Tax Code,

B) the operator certifies that the project meets the 1250 requirements,

C) was constructed or acquired pursuant to a binding written contract entered into on or before August 16,1986, and

D) is placed in service prior to January 1, 1989.

Relief Period: The "relief period" commences with the taxable year the investor made his/her initial investment and ends at the earliest of

A) the sixth taxable year after the year of the investor's initial investment, or

B) the taxable year after the year in which the investor's final investment is due, or

C) the last year the project is deemed a "qualified low-income project"

ATTACHMENT #7

Case Study # 3:

GBCD Existing Partnerships

Approach with Investors

In the weeks immediately following passage of the Tax Reform Bill of 1986, GBCD analyzed the impact of the Bill on the investors in each of our Partnerships. We sent letters to the investors in each deal summarizing the impact of the Bill on their investment.

For investors who benefitted from the low-income transition rule, we stressed that they would be able to deduct all losses through their pay-in period and that these losses would not be included in income for Alternative Minimum Tax purposes. For those investors who were subject to the phase-out of deductibility of passive losses, we focused on prior benefits and rates of return. In both cases, we suggested the benefits to investors to use or construct passive income sources in their investment portfolios in order to maximize the benefits of their partnership investment.

Given the minimal negative feedback received as a result of these letters, and the fact that in virtually every case it would not be advantageous for the investors to default, we do not anticipate problems in our collection efforts in this or future years.

Attached are:

1) Sample letter to investors benefitting from low-income transition rule
2) Sample letter for investors subject to phase-out transition rule
3) Investor financial profile for special transition rule investors
4) Investor financial profile for phase-out rule investors
5) Cost/Benefit Default Analysis

GREATER BOSTON COMMUNITY DEVELOPMENT INC.
79 MILK STREET • BOSTON, MASSACHUSETTS 02109 • (617) 482-6553
PATRICK E. CLANCY, Executive Director

October 23, 1986

Re:

Dear :

As you no doubt are aware, President Reagan signed the Tax Reform Bill of 1986 (the "Bill") on October 22. This bill will significantly change Federal income tax law. Consequently, we would like to take this opportunity to discuss the provisions of the Bill which will affect your investment in (the "Partnership").

Rate Changes

The most obvious impact of the Bill is the decrease in the maximum federal marginal tax rate from 50% to 38.5% in 1987 and to 28% (or 33% for individuals with incomes in certain ranges) for 1988 and beyond. This reduces the after-tax value of the projected losses from this investment.

Tax Shelter Restrictions

Another area of concern in recent months was the phase-out and eventual elimination of current deduction of "passive losses" against other (salary or portfolio) income. However, as a result of extensive lobbying efforts by members of the low income housing industry, including efforts on our

part, a "transition rule" was incorporated into the Bill. This transition rule is very good news for the limited partners in . It will allow you to deduct all losses allocated to you for the years 1986 through 1990 inclusive. Your last payment to the partnership is due in 1990. Therefore, you are fully protected during the pay-in period. Furthermore, you can help to ensure yourself of the ability to utilize the losses generated by after 1990 by creating additional passive income sources with your own investment. Passive losses are permitted to be used to shelter passive income, which includes any income from rental activities and most income from limited partnership investments.

Alternative Minimum Tax Changes

Another area where changes contained in the Bill could affect your tax situation is the Alternative Minimum Tax (AMT). Although the language of the Bill is open to interpretation, it appears that tax losses received through limited partnerships will not be considered a preference item for purposes of calculating the AMT. We suggest you consult your accountant or tax attorney with regard to this matter.

In sum, we hope that the combination of the special transition rule for low-income housing investments and the overall reduction in tax rates will enable you to benefit overall from the Tax Reform Act of 1986, and we are pleased if our efforts have helped to make that possible.

We will provide you with revised projections of your 1986 and future tax losses by mid-November. If you have any questions concerning your investment, please give Larry Einzig of this office a call.

Sincerely,
GREATER BOSTON COMMUNITY DEVELOPMENT, INC.

By: Patrick E. Clancy
Executive Director

PEC/dh
0651A

GREATER BOSTON COMMUNITY DEVELOPMENT INC.
79 MILK STREET • BOSTON, MASSACHUSETTS 02109 • (617) 482-6553
PATRICK E. CLANCY, Executive Director

October 28, 1986

Re:

Dear :

As you no doubt are aware, on October 22, 1986, President Regan signed the Tax Reform Bill of 1986 (the "Bill"). This Bill will significantly change Federal income tax law. Consequently, we would like to take this opportunity to discuss the provisions of the Bill which will affect your investment in (the "Partnership").

Rate Changes

The most obvious impact of the Bill is the decrease in the maximum federal marginal tax rate from 50% to 38.5% in 1987 and to 28% (or 33% for individuals with incomes in certain ranges) for 1988 and beyond. Although this reduces the after-tax value of the projected losses from this investment, we feel most taxpayers will benefit overall from these reductions.

Tax Shelter Restrictions

Another area of concern in recent months was the phase-out and eventual elimination of current deduction of "passive losses" against other (salary or portfolio) income. However, as a result of extensive lobbying efforts by members of the low income housing industry, including efforts on our part, a "transition rule" was incorporated into the

Bill. This transition rule phases in the elimination of current deduction of passive losses. This phase-in schedule is as follows:

Year	Allowable % of Deductible Losses
1986	100%
1987	65%
1988	40%
1989	20%
1990	10%
1991 and beyond	0%

These percentages and the the eventual elimination of deductibility of passive losses assumes that you will have no passive income in the future. Passive income generally consists of income from rental activities and non-participatory interest in trades or businesses. It excludes salary, income from trades or businesses in which you participate, and portfolio income, such as dividends, interest and royalties. You may utilize all passive losses generated from this and other investments in your portfolio to the extent you have passive income. Therefore, to maximize the tax benefits from the Partnership, you should consider creating additional passive income sources within your investment portfolio.

Alternative Minimum Tax Changes

Another area where changes contained in the Bill could affect your tax situation is the Alternative Minimum Tax (AMT). Although the transition rule described above will allow you to deduct a portion of your tax losses for purposes of the general income tax liability, tax losses received through limited partnerships will no longer be considered a deduction for purposes of calculating the AMT. To determine whether this change will have an impact on your ultimate tax liability, your entire investment portfolio must be considered. There is, of course, the potential to adjust your portfolio to minimize the impact of these changes. We suggest you consult your accountant or tax attorney with regard to this matter.

I would like to take this opportunity to summarize the benefits you have received to date as well as estimated benefits through 1990. This analysis assumes that you were in the 50% marginal tax bracket through 1986 and will be in the top marginal tax bracket thereafter.

Actual Results Through 1985

Year	Capital Contribution	Tax Losses	Tax Bracket	Allowable %	Tax Savings*	Net Benefit (Cost)
1981	$ 5,800	$ 4,951	50%	100%	$ 2,476	($3,325)
1982	17,100	35,469	50%	100%	17,735	635
1983	13,500	35,966	50%	100%	17,983	4,483
1984	12,500	32,479	50%	100%	16,240	3,740
1985	13,000	30,694	50%	100%	15,347	2,347
Subtotal	$61,900	$139,559			$69,789	$7,880

Estimate of Future Results

					Net Benefit (Cost)	
Year	Capital Contribution	Tax Losses	Tax Bracket	Allowable %	Assuming No Passive Income Sources	Assuming Passive Income Sources
1986	$ 8,100	$25,000	50%	100%	$ 4,400	$ 4,400
1987	0	12,800	38.5%	65%	3,203	4,928
1988	0	10,500	28%	40%	1,176	2,940
1989	0	7,000	28%	20%	392	1,960
1990	0	5,000	28%	10%	140	1,400
Subtotal	$8,100	$60,300			$9,311	$15,628
TOTAL	$70,000	$199,859			$17,191	$23,508

*Tax Savings = Tax Losses multiplied by Tax Bracket multiplied by Allowable Percentage.

Please note that this schedule assumes a one unit investment.

Thus, it is estimated that by 1990, you will receive total net benefits of $23,508 if you have passive income sources. Since in all years except 1981 your tax savings were or will be greater than the capital contribution for that year, your real net investment is as specified in the Net Benefit (Cost) column (Tax Savings minus Capital Contributions). As a result, your internal rate of return on this basis through 1990 is estimated to be approximately 74.6%. Assuming you will have no passive income sources, your IRR would be approximately 72.2%. This analysis does not include the potential savings associated with state taxes, losses after 1990, or the benefits and costs of a sale or refinancing of the property.

Therefore, although the income tax rate changes will reduce the after tax value of projected losses from the Partnership, we hope you will agree that this investment has already yielded positive returns. In addition, substantial future benefits are still possible, especially if you have or will create passive income sources for 1987 and beyond.

If you have any questions concerning this or any other matter pertaining to your investment, please do not hesitate to contact me.

Sincerely,

Lawrence Einzig
Manager, Investor Services

LE/dh
0576A

cc: Robert S. Parks, Jr.

Effect of Tax Reform Bill of 1986 on Typical GBCD Investor
Assuming Phase Out Transition Rule *

	1986 (1)	1987	1988	1989	1990	1991 and beyond
Adjusted Gross Income	$200,000	$200,000	$200,000	$200,000	$200,000	$200,000
Losses from Limited Partnership	40,000	26,000	16,000	8,000	4,000	0
Taxable Income	160,000	174,000	184,000	192,000	196,000	200,000
Tax Liability (2)	80,000	66,990	51,520	53,760	54,880	56,000
After-Tax Income (3)	120,000	133,010	148,480	146,240	145,120	144,000
Installment Payment to Partnership	20,000	20,000	20,000	20,000	20,000	20,000
Income after taxes and installment	100,000	113,010	128,480	126,240	125,120	124,000

* This transition rule phases out the deductibility of passive losses. 65% of partnership losses allowed in 1987, 40% in 1988, 20% in 1989, 10% in 1990, and 0% in1991 and beyond.

(1) 1986 figures show the situation prior to the Bill. Subsequent years detail the impact of tax reform.

(2) Assumes marginal tax bracket of 50% in 1986, 38.5% in 1987, and 28% in 1988 and beyond.

(3) Adjusted Gross Income minus Tax Liability.

Effect of Tax Reform Bill of 1986 on Typical GBCD Investor
Assuming Low-Income Transition Rule

	1986 (1)	1987	1988 and beyond
Adjusted Gross Income	$200,000	$200,000	$200,000
Losses from Limited Partnership	40,000	40,000	40,000
Taxable Income	160,000	160,000	160,000
Tax Liability (1)	80,000	61,600	44,800
After-Tax Income (2)	120,000	138,400	155,200
Installment Payment to Partnership	20,000	20,000	20,000
Income after taxes and installment	100,000	118,400	135,200

(1) 1986 figures show the situation prior to the Bill. Subsequent years detail the impact of tax reform.

(2) Assumes marginal tax bracket of 50% in 1986, 38.5% in 1987, and 28% in 1988 and beyond.

(3) Adjusted Gross Income minus Tax Liability.

If Investor Defaults:

	Year	Tax Preference	Capital Account	
ITC	1985	8,175	8,097	
	1986	0	4,432	(At time of default)
ITC Recapture		8,175	4,432	Capital Loss
ITC Recapture		8,175	8,175	
Capital Loss times .28 (Assumes invstr has gains to offset)		(1,255)	0	(Assumes invstr has no gains to offset)
Total Tax Liability		6,920	8,175	

If Investor Makes Payment

Year	Payment	Tax Loss		Assuming No Passive Loss Sources: Tax Benefits Assuming Mass Tax	Assuming No Passive Loss Sources: Tax Benefits Without Mass Tax	Assuming Passive Loss Sources: Tax Benefits Assuming Mass Tax	Assuming Passive Loss Sources: Tax Benefits Without Mass Tax
1987	1,900	4,272		1,154	1,069	1,776	1,645
1988	2,000	4,281		541	479	1,353	1,199
1989	2,025	3,809		241	213	1,204	1,067
1990	1,825	3,669		115	103	1,159	1,027
	7,750	16,031		2,052	1,865	5,492	4,937
			minus remaining payments	7,750	7,750	7,750	7,750
			Net (Dis)advantage	(5,698)	(5,885)	(2,258)	(2,813)

SUMMARY

Net (Dis)advantage to Stay In:	(5,698)	(5,835)	(2,258)	(2,813)
minus Net (Dis)advantage to Default:	(6,920)	(6,920)	(6,920)	(6,920)
Overall (Dis)advantage to Stay In:	1,222	1,035	4,662	4,107